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CULTURE AND CONDUCT IN FINANCIAL SERVICES: UK REGULATORY AND EMPLOYMENT DEVELOPMENTS

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Good and poor practices - conduct in the workplace

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New normal



**Hybrid
Working**



**Employee
Conduct**



**Market
Conduct**



Training

Proactive Approach



Market misconduct





**Maintaining a positive
and inclusive culture
and addressing
personal misconduct in
a regulatory context**

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What is a 'good' culture?

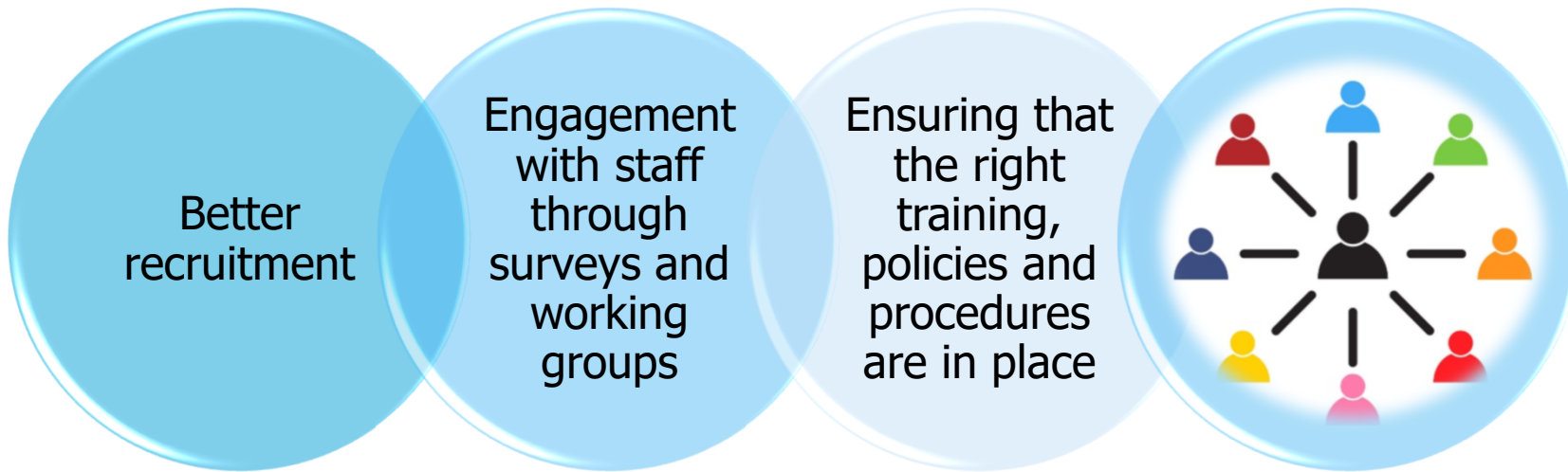
Poor culture was found to be one of the root causes of the 2008 financial crisis

The FCA does not take a prescriptive approach

Firms with good cultures are often seen as those:

- where people have the ability to speak up in a safe environment
- where managers lead by example
- where there is a strong focus on an inclusive environment and deliberate focus on the expected behaviours from staff

How to improve / change your culture?



Non-financial misconduct



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FCA bans Jon Frensham from working in financial services



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The FCA has banned director Jon Frensham (formerly known as Jonathan James Hunt) from performing any regulated activity.

Jon Frensham was banned by the FCA for non-financial misconduct outside of the workplace that impacted his fitness and propriety, specifically, his integrity and reputation

The case demonstrates the importance of non-financial misconduct in the context of assessing fitness and propriety

Senior managers or certified employees

Rise in number of cases where actions are being taken against senior managers or certified employees who have misbehaved

Often related to sexual harassment, sometimes in relation to incidents that take place in a social setting outside the workplace

Opportunity for employers to address wider work-place issues

Further considerations:

Duty to notify the FCA under principle 11

Need to re-assess someone's fitness and propriety with a particular focus on integrity, honesty and reputation

Whether the conduct in question amounts to a breach of COCON



Dealing with overlapping grievance, disciplinary, and whistleblowing issues

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Key considerations (1)

Once one formal process is started (e.g. disciplinary proceedings), others can quickly emerge (e.g. grievances and whistleblowing)

Delineate and keep track as best as possible of these multiple processes

Often, disciplinaries and grievances can be addressed together when relating to the same underlying fact pattern – efficient

Whistleblowing complaints should be addressed through internal whistleblowing channels

Consider at an early stage the relevant investigators (internal / external) and decision-makers for each track

Legal professional privilege:

- To help address subsequent Tribunal claims, keep an 'open' process regarding the disciplinary and grievance
- Whistleblower allegations commonly investigated on a legally privileged basis – set-up of investigation requires careful thought

Key considerations (2)

Suspension

- May be appropriate in case of serious misconduct (e.g. where employee poses threat to business / other employees, or may interfere with investigation)
- Should be carefully considered – no 'knee-jerk' reactions
- With pay, as brief as possible, and kept under review


Sickness absence

- Risk of sickness absence following notification of formal process, especially disciplinary process
- Conflicting priorities: dealing without unreasonable delay vs. inability to participate for genuine ill-health
- Unless likely to resolve, often appropriate to call on OH (fitness to work not necessarily the same as fitness to attend formal process)
- Adjustments? Seek to re-arrange?
- Proceed in the employee's absence?

Legal representation?

Regulatory notifications





**Employment and
regulatory issues arising
from the pandemic,
including hybrid working,
managing people, and
conducting investigations
remotely**

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Practical issues arising from the pandemic (1)

Regulated firms must fulfil compliance obligations while many employees are working remotely

- SMCR compliance processes may need to be adapted, especially if they rely on multiple individuals across different departments and offices
- Managers may need to find new methods of discharging delegation and oversight duties
- Firms may need to update policies and refresh training to reflect new remote working environment
- Important to maintain an open dialogue with staff, especially re returning to office

Culture challenges

- Maintain good and open culture (especially important in the current climate)
- Staff may disregard rules if feel not being monitored or supervised at home

Training challenges

- Think carefully about the different roles performed by staff; generic online training on the Conduct Rules may not achieve goal
- Consider how to monitor whether individuals have completed training as opposed to simply 'flicking' through the pages without reading them



Practical issues arising from the pandemic (2)

Employees may want to work remotely, abroad, for a prolonged basis. These working arrangements can create compliance, employment, regulatory and tax risks.



Employment law

- Potential multiplicity of employment rights in different countries
- Employee might be able to cherry-pick most favourable rights/jurisdiction



Tax

- Complex income tax and social security arrangements, dependent on place of residence / working time
- Specialist tax advice often required



Compliance/regulatory

- Rules can differ by jurisdiction
- Rules can also be extraterritorial, e.g. for UK authorised firms, SMCR may apply to senior managers based overseas

Conducting investigations remotely

Assess impact of possible reduction in workforce (through redundancy / furlough) including on custodial interviews, witness availability and adequacy of legal hold

Assess impact of remote working particularly on document collection and witness interviews

Document collection

- Adequacy of legal hold: does it address the multiple ways that employees may now be communicating and storing work product?
- Custodian and data map: does it identify the various locations and accessibility of physical documents and electronic data?
- Protocols and tracking: have secure protocols been established for the handling and transmittal of data? Do they address all issues e.g. GDPR and privilege? Is the data collected thoroughly logged and tracked?

Witness interviews

- Planning and scheduling: in person or via video conference? Timing?
- Parameters of video interviews: have clear ground rules been established with the witness in advance? Who will be present? How will documents be shared? How will the interview be memorialised? What is to happen if there are technological issues?



Key regulatory considerations, including notifying regulators of breaches and handling regulatory references

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Key regulatory considerations, including notifying regulators of breaches and handling regulatory references

Principle 11 remains as paramount as ever. Remote / hybrid working and its consequences is not an excuse for failing to identify and notify regulatory breaches in a timely manner.

- Areas requiring particular focus: data, cyber and security risks and ability to meet specific regulatory requirements such as call recordings, trade surveillance and consumer system access.

Regulatory references are arguably even more key in the remote working / hybrid environment (e.g. it's more difficult for a prospective employer to assess a candidate and greater reliance is likely to be placed on a regulatory reference)

- Question G considerations.

Non-financial misconduct

Non-financial misconduct may not always be clear-cut

Consider:

evidence of the alleged wrongdoing

seriousness of the alleged wrongdoing

mitigating circumstances

Consequences where a senior individual suddenly leaves a company with no handover may be financially catastrophic

Settlement agreements

Regulatory reference wording may need to be agreed

Critical that a firm does not do anything in relation to the reference that might suggest they have fettered their regulatory obligations and references will need to be true, accurate and not create a misleading impression overall

Settlement agreements will be potentially disclosable



Trend where the regulatory notification documents themselves are incorporated within the settlement agreements – BE CAREFUL!



The new Investment Firms Prudential Regime and Remuneration Code update

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New remuneration requirements under the UK investment firm prudential regime



It will apply to FCA authorised investment firms' performance periods beginning on or after 1 January

It will be set out in the new MIFIDPRU Remuneration Code

It will become the new SYSC 19G and will replace the BIPRU and IFPRU Remuneration Codes for certain investment firms

MIFIDPRU Remuneration Code

The MIFIDPRU Remuneration Code will apply to:

- All FCA authorised MiFID investment firms, such as investment firms that are currently subject to the BIPRU and IFPRU Remuneration Codes and exempt CAD-firms
- Collective portfolio management investment firms (which will be subject to both the AIFM and MIFIDPRU Remuneration Codes and will be required to adhere to the most stringent of any conflicting requirements under those codes); and
- Regulated and unregulated holding companies of groups containing an FCA authorised MiFID investment firm and/or a collective portfolio management investment firm

Basic, standard and extended requirements

The new remuneration requirements are divided into basic, standard and extended requirements

A firm is a **non-SNI firm** if it meets certain thresholds e.g. having AUM of at least £1.2 billion, holding any client or client assets, holding permission to deal on own account, having an on- and off-balance sheet total of at least £100 million or having total annual gross revenue from investment services of at least £30 million

An SNI firm would be subject to only the basic requirements under the MIFIDPRU Remuneration Code whereas a non-SNI firm would be subject to both the basic requirements and standard requirements

A non-SNI firm would also be subject to the extended requirements under the MIFIDPRU Remuneration Code

The basic requirements under the MIFIDPRU Remuneration Code apply to all staff, whereas most of the standard requirements apply only to MRTs (non-SNI firms need to assess at least once a year which of its staff members are MRTs)

Examples of an MRT

A staff member that is a **member of the firm's management body**

A **staff member that is responsible for managing a material risk within the firm**

A **staff member that has authority to take decisions approving or vetoing the introduction of new products**

A staff member that has **managerial responsibility for (i) business units managing investments or advising on investments; or (ii) the activities of a control function such as a risk management, compliance or internal audit function**

A **staff member that is responsible for managing IT, information security and/or outsourcing arrangements of critical or important functions**

Performance adjustment for non-SNI firms

Non-SNI firms must ensure that any variable remuneration (including any deferred portion) is paid or vests only if sustainable according to its financial situation as a whole and justified on the performance of the firm, business unit and individual

A non-SNI firm must also:

- Ensure that all of the total variable remuneration is subject to in-year adjustments, malus or clawback arrangements
- Set specific criteria for applying malus and clawback that cover situations where the MRT participated in or was responsible for conduct that resulted in significant losses to the firm and/or failed to meet appropriate fitness and propriety standards (*and so remuneration must be adjusted by reference to an MRT's conduct and not just his/her financial performance*).

However, a non-SNI firm that will not be subject to the extended requirements under the MIFIDPRU Remuneration Code and will not be subject to the requirements to defer portions of variable remuneration

A non-SNI firm must ensure that the clawback period spans at least the combined length of any deferral and retention periods and allows sufficient time for any potential risks to crystallise



Questions?

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Coronavirus COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

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To help keep you on top of developments as they unfold, we also have launched a resource page on our website at

[www.morganlewis.com/
topics/coronavirus-
covid-19](http://www.morganlewis.com/topics/coronavirus-covid-19)

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple "Stay Up to Date" button.



Biography



Louise Skinner, Partner

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Louise Skinner provides sophisticated, strategic advice on all aspects of employment law, with particular focus on regulatory employment matters. Described as “truly exceptional and insightful” by clients in *The Legal 500 UK* guide, Louise advises on issues including investigations, contractual disputes, whistleblowing, discrimination and restraint of trade. Louise has a particular focus on the financial services, life sciences, sports, media, and entertainment industries.

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Lee Harding, Partner

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Lee Harding has a broad and versatile practice that goes beyond the provision of traditional legal services. Lee's practice is focused on the myriad legal implications arising out of a rapidly changing workplace: flexible working, five generations in the workplace, giving workers a voice, and the crossover between employment and the regulatory environment, to name but a few. The nontraditional legal services that Lee offers require a proactive approach to managing workplace issues before they escalate. He engages with a wide range of stakeholders to deliver sophisticated and actionable solutions that resonate across the entire business.

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Melanie Ryan, Partner

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Melanie Ryan represents clients in commercial litigation and disputes, corporate and regulatory investigations, and related enforcement proceedings. She advises clients across a range of areas with a particular focus on the banking, financial services, and energy sectors. Melanie is head of the firm's disputes practice group in London.

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Steven Lightstone advises on financial services, securities, and derivatives regulatory issues. His clients include asset managers across a wide range of asset classes and their funds, banks, broker-dealers, fintech firms, payment institutions, institutional investors, insurers, lenders, and market associations.

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Thomas Twitchett advises national and multinational clients on all aspects of UK employment law. With a particular interest in dispute resolution and litigation, Tom assists clients with internal investigations, forfeiture processes, exits, grievances, and disciplinaries, and represents clients in Employment Tribunal and High Court proceedings. He also counsels clients on the employment law aspects of transactions and helps clients more generally to navigate legislative updates and the growing impact of FCA and PRA regulation.

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